

Sechin's Little Secret

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By Konstantin Sonin

An economist would normally criticize Deputy Prime Minister Igor Sechin. He rarely says anything meaningful in terms of economics. But twice in the past two weeks, it was necessary to come to Sechin's defense. First, he was right in saying that Russia does not need a production sharing agreement, or PSA. Second, claims that Russia's agreement to provide China with oil is unprofitable for Russia might really turn out to be groundless. But the lack of understanding on the subject and the controversy surrounding it attests to the lack of transparency in the agreement. This is an unacceptable situation, particularly when it involves such an important strategic interest.

Russia currently has three PSAs that are intended to protect foreign investors from political risks. Such agreements were specially created to allow major international corporations to sign long-term contracts with unpredictable, authoritarian regimes. In many countries, these PSAs have proven at least partially successful at protecting foreign investors from changes in leadership. But there is a certain stigma attached to them since they are only needed in unstable countries. In stable states with a safe investment climate, foreign investors do not require special protection because all investors are protected equally.

Although Russia does not need insure foreigners against risks connected with its own behavior, it might need to insure itself against the risks involved in deals with other countries.

Thus, there might be good reason to consider Russia's agreement to sell oil to China at \$55 to \$60 per barrel as some form of insurance, considering that the deal only becomes profitable at a price of \$80 per barrel. The idea of any insurance policy is that it chews up a certain percent of the profit when everything is going well but saves the insured party from major losses if things go badly.

Of course, the insurance premiums themselves can prove to be the cause of financial loss. When a driver has accumulated enough years without an accident, the total amount of paid insurance premiums can often exceed the original cost of the car. Thus, criticism rained down on Sechin from all sides for having orchestrated an unprofitable agreement with China. But its profitability can only be gauged once all the terms of the agreement are finally made public.

That disclosure process should happen as soon as possible. The rules are very simple: If an economic agreement is signed in the best interests of the country, there is no reason to hide anything. If the agreement is sound, it will naturally withstand criticism from political opponents, analysts and the press. The fact that leaders are afraid to reveal the terms is probably a sign that the agreement has problems. If the agreement with China is flawless, why keep it secret?

Russia already has enough corruption without adding speculation about whether the agreement with China was on the up and up. If, however, anything underhanded is involved here and the agreement is not sound, Sechin's contract with China might go down in history like the notorious privatization auctions of the early 1990s.

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